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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

January 13, 1983

B-199244

The Honorable James J. Howard
House of Representatives

Dear Mr. Howard:

Subject: Comments on Options To Reorganize the General Public Utilities Corporation (GAO/RCED-83-84)

Your September 1, 1982, letter requested that we comment on several questions related to (1) helping reduce the financial burden on the ratepayers of the accident at Three Mile Island (TMI) and (2) rebuilding a sound financial base for its owners. In accordance with agreements reached with your office, we are providing a written summary of the information we developed. This letter summarizes the answers to your questions. Your specific questions and our detailed responses are provided in enclosure I.

As agreed with you, we reviewed information previously developed by GAO and other organizations that have studied the issues at TMI. We also interviewed and obtained information from a wide cross section of individuals involved with TMI. They include representatives from the Securities and Exchange Commission (SEC); the Nuclear Regulatory Commission (NRC); the Federal Energy Regulatory Commission (FERC); the Edison Electric Institute; the State utility commissions in New Jersey and Pennsylvania; the Governor's office in Pennsylvania; the General Public Utilities Corporation (GPU) which owns TMI; and various members of the financial community, including investment bankers and specialists in electric utility financing. We also attended a public hearing conducted by NRC on November 9, 1982, in Harrisburg, Pennsylvania, regarding the restart of TMI-1. Our review was done in accordance with generally accepted government audit standards.

Your first questions inquired about the viability of reorganizing GPU, either by a public takeover or through a diverstiture. The individuals we interviewed generally agreed that the reorganization options offered are not viable because they would not expedite the cleanup process, reduce the impact of the accident on consumers

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served by the utility, or reduce the cost of providing current and future service. In addition, if such options were pursued, it would tend to shift the focus away from the important issues of the clean-up to those of much less consequence. The consensus of those we contacted was that the cleanup issue has to be resolved before either a public takeover or divestiture can realistically be considered.

Your next question was directed at potential avenues for capital enhancement available to GPU. Most officials we contacted stressed how crucial it is, from a financial viability perspective, to restart TMI-1 as soon as safely possible. Once the unit is re-started, the short-term financial position of the company would be enhanced, and under current State commission rate orders, additional funds would be available for TMI-2 cleanup. This would also provide some flexibility in developing the long-term actions required to ensure that the company can expand to meet future service demands.

Your final question addressed the management of GPU. The respondents we interviewed do not believe that the company's management will inhibit the recovery of a sound financial base for the utility; in fact, many complimented the initiatives taken by company management in the wake of the accident. Some minor problems were identified by one State commission, but they were not viewed as obstructions to financial recovery.

We did not obtain official comments on the information presented in this report; we did, however, discuss the material with representatives from GPU, the electric utility industry, and the financial community. Their comments have been incorporated into the report where appropriate.

As arranged with your office, this report will be made available to the public when it is provided to you. We will also send copies to the respondents we interviewed and provide copies to others upon request.

Sincerely yours,

for J. Dexter Peach
Director

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DETAILED GAO RESPONSES TO CONGRESSMAN HOWARD'S QUESTIONS

1. Question: "Due to continuing economic problems and revised cost estimates for cleanup of Three Mile Island Unit Two * * * is a public takeover of General Public Utilities a viable option to help reduce the financial burden on ratepayers in the GPU service area?"

2. Question: "Is divestiture of any of General Public Utilities subsidiaries an action which will assist in resolving GPU's financial dilemma to the benefit of utility consumers?"

Answer: The options of a public takeover or divestiture/merger have been studied and discussed by the States, the electric utility industry, and the financial community but have been generally discarded because they were perceived as unrealistic. Too many questions exist regarding (1) funding that would be required, (2) property value of GPU assets, particularly TMI, and (3) the cleanup liability, to make either type of reorganization a desirable alternative.

Either a public takeover or a divestiture/merger would be a major alteration of GPU that would separate the three operating companies currently controlled by the holding company. A public takeover would place the management and operation of GPU, including TMI, under the jurisdiction of either a joint or separate Pennsylvania/New Jersey public power authority. A divestiture/merger would also modify the GPU organization by separating Jersey Central and either merging it with another existing utility or letting it "stand alone." Similar decisions would be required regarding the disposition of the two remaining GPU companies in Pennsylvania. Either of these reorganization actions would trigger several major financial actions. According to SEC and GPU officials, the indentures of the companies require that in the event of a reorganization or bankruptcy, the long-term debt instruments immediately become due and payable. The companies have a consolidated debt of about $2 billion at an estimated embedded interest rate of 8 percent. GPU and financial officials agreed that if a reorganization were to occur, this debt would have to be refinanced at current interest rates which would be approximately twice GPU's embedded rate, thereby doubling the interest costs charged to ratepayers.

The requirement for large sums of money would not be limited to debt satisfaction, however, because the asset value of the companies would have to be determined and appropriate compensation provided to stockholders. Regulatory officials and specialists in utility financing told us that this factor could have the greatest impact on the consumer rates that would ultimately be levied by the new organization.

In addition, determining a fair value for the property would most likely involve lengthy litigation aimed at protecting the financial interests of GPU's investors. This process would be complicated by questions of whether the asset compensation should be based on current book value, replacement value, market value, or some other valuation criteria. SEC officials told us that this question took about 5 years to settle in the Penn Central Railroad case and offered the opinion that for GPU the litigation could be expected to be equally protracted.

Industry officials observed that a major reorganization could send a message of uncertainty to the financial community which may develop the perception that utilities with nuclear units pose a greater lending risk. This could in turn result in increased capital and borrowing costs which would be passed through to utility customers.

Either a public takeover or a divestiture/merger would face scrutiny from NRC because it would view such action as a license amendment. The more extensive the reorganization, the more complicated would be NRC's review. Officials from NRC indicated that the Commission's primary concern would be the impact of the reorganization on the financial status of the cleanup program and its effect on the health and safety of the public. They also indicated that the Commission would not be in favor of any action that would jeopardize the financial integrity of the cleanup program.

In a public takeover, a method of funding the reorganization would have to be established, which would probably mean selling bonds. Pennsylvania State officials are opposed to this option, however, because they do not believe the State's bonding authority should be used for this option.

Two other factors also discourage a public takeover. Neither New Jersey nor Pennsylvania has the infrastructure necessary to operate a major utility company. New State agencies would have to be created with attendant staffing requirements. Officials from GPU and Pennsylvania told us that these measures have no legislative support. GPU officials also stated that public takeover by both States would require congressional approval because an interstate compact would be formed. 1/

GPU and SEC officials pointed out that the State-financed covenants which would be used to fund a public takeover would most

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1/Article 1, Section 10 of the U.S. Constitution requires that no State shall enter into any agreement or compact with another State without the consent of Congress.

likely contain provisions--similar to those of other public power authorities--requiring the immediate pass-through of all costs of providing service on a current basis. In some cases, this includes interest on indebtedness incurred and a return on the capital used to finance the construction of new facilities not yet in service. These requirements would eliminate the "regulatory lag" that may work to the benefit of consumers served by nongovernmental utilities. At GPU, for example, due to the time intervals between the filing of utility applications for rate increases and regulatory commissions' decisions on such applications, customers may pay less than the actual cost of current service. Furthermore, incorporating the GPU system into a public power authority structure would not eliminate the cost of or responsibility for cleaning up TMI-2. Considering all these factors, therefore, a public takeover of GPU not only could take years to complete but would probably result in an increase in the rates consumers would pay for electricity.

A divestiture/merger would face many of the same questions regarding asset value as a public takeover, yet raise an added factor of locating a company that would be willing to enter into a business arrangement filled with the large and uncertain financial liabilities associated with TMI. The individuals we interviewed generally agreed that there is no economic advantage to a divestiture/merger; in fact, if it were attractive, they believe that it would have already occurred because the marketplace would have realized its merits and value. This option is not attractive because the cost of the cleanup is not known, and no company would want to merge with one or more of the GPU companies until the cleanup costs are established. It is generally agreed that each of the GPU companies is responsible for its share of the cleanup in proportion to its ownership share in TMI-2. Therefore, while each company's share of the cleanup liability may be known, the ultimate costs are uncertain.

GPU has estimated tha about $760 million will be needed during the 1982-87 time frame to clean up the TMI-2 facility. On July 20, 1982, we reported to the House Chairman and Ranking Minority Member, Committee on Interior and Insular Affairs, that if adequate financial resources can be provided to GPU so that required cleanup operations can proceed with minimal delays, the cleanup could be accomplished for about $113 million less than GPU's estimate. If, however, funding uncertainties continue to persist and funds are not available when needed, cleanup costs could escalate beyond the $760 million projection.

It is possible that a merger would allow cleanup costs to be spread over a larger consumer base, thereby reducing the individual consumer cost for TMI-2 cleanup. However, GPU officials expressed the opinion that such a plan would meet with consumer

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resistance in principle because under this type of reorganization, consumers of the acquiring organization not previously paying for the cleanup would be required to contribute.

3. Question: "It is increasingly unlikely that Congress will act on the issue of cleanup funding in the 97th Congress or any of several cost-sharing plans to assist in resolving this problem. What avenues of capital enhancement are available to GPU other than direct rate increases to utility ratepayers in the service area?"

Answer: We have viewed capital enhancement from two perspectives--funding for TMI-2 cleanup and GPU's financial viability. No significant financial market resources are available to GPU for funding cleanup costs. The only other external sources available are Federal, State, and utility industry contributions that would result from the full implementation of the Thornburgh proposal. 1/ GPU's continued financial viability is heavily dependent on restoring its access to the capital markets, which in turn is dependent on restoring idle capital investments to an earnings position. The restart of TMI-1, therefore, would not only enhance the company's short-term financial position but would provide some flexibility in meeting its longer-term needs.

GPU has been unable to access the capital markets for long-term financing for two primary reasons. The decline in earnings for the operating companies reduced their interest coverage ratio below the legal minimum required to issue long-term securities. Following the accident at TMI-2, the companies' bond ratings were reduced to the point where they are considered to be below investment grade with limited appeal to investors. Even if the securities were marketable, however, financial institutions are not likely to loan money for cleanup purposes since the use of the funds would have no revenue-producing potential to ensure repayment.

The only available external funding for the cleanup, therefore, is encompassed in Governor Thornburgh's proposal. The Federal Government and the utility industry are the two largest external contributors envisioned in the proposal, with each party apportioned about $190 million as its share over a 6-year period. The Federal Government contribution required congressional action and this has partially occurred with the approval of a $123 million Department of Energy research and development (R&D) program at TMI. The potential offset to the estimated cleanup costs from the R&D expenditures,

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1/On July 9, 1981, Governor Dick Thornburgh of Pennsylvania proposed a shared approach for funding the $760 million cleanup cost. His plan was based on contributions by the Federal Government, the States of Pennsylvania and New Jersey, the electric utility industry, and GPU's customers.

however, is estimated to be only about $53 million. Any additional Federal contributions will require further congressional action.

The utility industry was receptive to its proposed share of the cleanup costs but requested a congressional mandate to ensure full participation by the various utility companies affected. Legislation has been introduced, 1/ but not enacted, to require cleanup contributions from utility companies. Both State and industry officials believe that TMI's problems could be solved more quickly if more congressional action was taken on the TMI cleanup issue. Some efforts, which may emerge in the near future, are being pursued within the utility industry to encourage voluntary multiyear cleanup contributions from investor-owned electric utilities.

Several financial analysts we interviewed stated that the cleanup should not be funded by GPU's customers alone. The accident provided many valuable lessons to other utilities with nuclear facilities, equipment manufacturers, and the Federal Government. Because of the information that will be provided to these and other entities, the analysts view them as additional sources of cash that should contribute to the rapid cleanup of TMI-2.

The Thornburgh proposal allocated about $245 million to GPU's ratepayers over a 6-year period. Ratepayer participation in the cleanup had been strongly resisted by Pennsylvania and New Jersey regulators, but both have now approved rate procedures which will provide for consumer participation in the TMI-2 cleanup and return TMI-1 to an earning status once the unit is restarted.

According to GPU and State officials, rate orders which became effective August 1, 1982, in Pennsylvania and July 1, 1982, in New Jersey mark the first time the State commissions have allowed consumer funding of the cleanup. The orders permit the companies to realize $32.3 million annually for the cleanup--$20.3 million from Pennsylvania customers and $12 million from those in New Jersey. When TMI-1 returns to service, the Pennsylvania Public Utility Commission has approved an increase of $14.5 million for Pennsylvania consumers which will raise the level of total annual customer funding of the cleanup to $46.8 million. 2/ GPU officials

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1/A number of bills have been proposed, the most prominent being H.R. 2512 and S. 1606. No committee action has been taken on H.R. 2512. S. 1606 was voted out of the Energy and Natural Resources and Environment and Public Works Committee but did not reach the floor of the Senate during the 97th Congress.

2/Additional cleanup funding of $1.6 million is also being sought from GPU's wholesale customers in recent rate filings before the Federal Energy Regulatory Commission.

estimated that these rate adjustments would be beneficial to both consumers and the cleanup effort. On a system-wide basis, they indicated that consumer rates would probably be reduced about 3 percent by the restart of TMI-1. At the same time, the rates would provide additional cleanup funding for TMI-2 and an increase in financial benefits for GPU.

Renewed access to the capital markets by GPU is necessary to sustain and enhance its financial viability. The most positive measure that can be taken to restore GPU's capital attractiveness is to restore its idle investments to an earnings position.

The officials we interviewed agreed that in determining whether or not to allocate funds to a company, the financial markets look to the earnings on investment as a measure of capital attractiveness. Company officials and utility analysts noted that GPU has three major investments amounting to about $1.2 billion that are not earning income. 1/ GPU has abandoned the Forked River facility and there is no near-term opportunity to return TMI-2 to an earnings position. Primarily because of the loss of the TMI units, the company estimates that through September 1982, it had lost earnings of about $370 million. This has been reflected in both dividend omissions and reduction of the bond interest coverage ratios for Metropolitan Edison and Jersey Central to levels that preclude these companies from issuing permanent securities.

According to GPU, the return of TMI-1 to service will increase the companies' earnings by about $50 million a year once TMI-1 is allowed back in the rate bases. Furthermore, the companies' coverage ratios will increase to the point where long-term debt could be issued. Consequently, the return of TMI-1 to service offers GPU the only readily available opportunity to increase its earnings potential.

GPU officials stressed that in order for GPU to remain a viable utility company, it will eventually have to proceed with other financial plans for long-term capital expansion programs that will be required to serve projected future growth. If the cleanup liability can be satisfied, the officials indicated that the company should regain its access to capital markets and again be viewed as a viable investment opportunity. This will coincide with the need to acquire financing for new generation facilities that will be required in the latter part of the decade.

1/TMI-1, TMI-2, and Forked River. The current unamortized level of investment in each of these facilities is $376 million, $608 million, and $204 million, respectively.

According to public hearings held by NRC on November 9, 1982, regarding the TMI-1 restart issue, most citizens in the vicinity continue to strongly oppose renewed operation of the plant for several reasons. Opinions expressed at the hearings reiterated a wide range of citizen concerns including the belief that (1) the generating equipment has deteriorated while the plant has been shut down and therefore cannot resume safe operation, (2) the emergency plan to be used in the event of a major accident is deficient and will not be practical in an actual emergency, (3) the company and plant operators cannot be relied upon to operate the plant safely and in the best interests of the public, and (4) NRC has lost its credibility and its regulatory process is inadequate to assure safe plant operation. The view of many hearings participants was that the restart of TMI-1 could be justified only if economic matters are to be considered; if, however, the primary emphasis is public health and safety and the quality of human life, then TMI-1 should remain shut down.

In addition to voicing these concerns, the citizens, in non-binding referendums in three counties, have voted by about two to one to keep the plant closed. The restart of TMI-1 has also been opposed by the mayor and city council in Harrisburg, Pennsylvania.

GPU officials noted that the voter referendums represented only 26 percent of those eligible to take a stand on the TMI-1 restart issue. The officials also believe that if NRC allows restart of the unit, it cannot be viewed as failing to give primary emphasis to the health and safety of the public; instead, they pointed to the conclusion in NRC's supplement to its environmental impact statement which observed that "* * * the combined effects of the cleanup of Unit 2 with normal operation of Unit 1 will result in insignificant risk to the public health."

NRC has been unable to set and maintain a date for deciding whether to lift the shutdown orders on TMI-1. The most recent date was December 21, 1982, but the decision has again been postponed. On December 29, 1982, NRC's Atomic Safety and Licensing Appeal Board decided to obtain additional information on the ability of the TMI-1 reactor to remove decay heat in the event of a loss-of-coolant accident. Because the Board believes that the existing record is unclear on this question, it is asking for supplemental testimony on a number of technical operational areas.

The Board has stated that it intends to proceed promptly in this effort, but it is not known when a full Commission decision will be made on this issue. Even if the shutdown orders were lifted immediately, there are still questions outstanding about some mechanical aspects of the reactor that have to be answered before NRC could authorize operation of the unit.

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In addition to the mechanical questions about the reactor, the United States Court of Appeals for the District of Columbia Circuit has imposed a duty upon NRC to consider the potential psychological health effects of operating TMI-1. NRC has appealed this decision to the Supreme Court, and the Court has accepted the case for review; a decision is expected sometime in midsummer 1983. The D.C. Circuit Court has also directed NRC to provide 30 days' notice to the court and petitioner if it intends to make a final decision regarding the restart of TMI-1 without considering the psychological stress issue.

4. Question: "Have the past management problems of GPU been resolved and if not, will these be stumbling blocks to the recovery of a sound financial base for the utility?"

Answer: GPU management is not considered to be a major issue among the respondents we contacted. The problems that beset the present GPU management--the cleanup of TMI-2 and the restart of TMI-1--are the keys to GPU's financial recovery. Many respondents complimented the initiatives taken by company management in the wake of the accident.

The financial analysts we contacted believe that the management of GPU has little impact on whether it is looked upon favorably in the capital market. Access to the market is based instead on financial performance in areas such as return on investment and dividends. The financial community would like for management to resume the payment of dividends, but State commission officials voiced opposition to this until a predictable and reliable plan is in place for funding the cleanup. The liabilities GPU faces in cleaning up TMI-2, not its management, affect the company's access to the capital market. Some minor management problems were identified by New Jersey Board members, but they were not viewed as obstructions to the financial recovery of the company.